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UNCLAS SECTION 01 OF 02 ASTANA 002931

SIPDIS

DEPT FOR SCA/CEN (O'MARA)
DEPT PASS TO OPIC - BALLINGER
DEPT PASS TO TDA FOR STEIN, EXIM FOR GLAZER
DEPT PASS TO AID - EE-PHILLIPS/RUSHING
USDOC FOR 4231/ITA/MAC/MLONDON, 4201/BISNIS
USDOC FOR 6110/ITA/TD/BI/RHALPERN
ANKARA FOR CFC

SENSITIVE

SIPDIS

E.O. 12958: N/A
TAGS: [ECON](#) [EIND](#) [ENRG](#) [EPET](#) [EFIN](#) [KZ](#)
SUBJECT: KAZAKHSTAN'S PROPOSED SUBSOIL AMENDMENT RATTLES FOREIGN
INVESTORS

ASTANA 00002931 001.2 OF 002

11. (SBU) Summary: On 27 September 2007, the Kazakhstani Parliament approved an amendment to the "Law on Subsoil and Subsoil Use" which, if signed into law, may have substantial negative consequences for the investment climate in Kazakhstan. The draft amendments give the Government of Kazakhstan (GOK) more power to terminate a subsoil use contract if it decides that the contractors' actions violate the national economic security interests of Kazakhstan. Interestingly, however, the amended law has awaited President Nazarbayev's signature for almost one month, perhaps signaling that he is at least giving second thought to an amendment sure to displease some of Kazakhstan's biggest foreign investors. End summary.

What the Draft Law Is

12. (U) On September 12, the Mazhilis (lower house of the Kazakhstani Parliament) initiated the process of amending the "Law on Subsoil and Subsoil Use". According to the accompanying executive summary provided by the Parliament, the purpose of the proposed law is to protect Kazakhstan's "national economic security interests." In doing so, the summary states, the draft law introduces "a real mechanism for ensuring compliance" with the National Security Law requirement that any contract relating to the use and/or sale of strategic resources be monitored for compliance with national security requirements.

13. (U) According to the amendment, in cases in which a subsoil user's operations cause substantial change to Kazakhstan's economic interest or result in a threat to the national security of Kazakhstan, the GOK will have the right to require that the subsoil user change and/or amend the terms and conditions of the contract in order to restore the economic and security interests of the republic. Additionally, this amendment gives the GOK the right to unilaterally refuse, on a month's notice, to perform its contractual obligations.

14. (U) The proposed amendment also expands the legal grounds for termination of a subsoil contract. Specifically, the GOK can terminate a contract under any of the following conditions:

-- If the contractor does not agree in writing to negotiations within two months of receipt of notification of the GOK's intent to amend the contract.
-- If the contractor and the GOK cannot reach an agreement within 4 months of the subsoil user's agreement to enter the negotiations.
-- If the contractor and the GOK do not sign amendments to the contract's terms within 6 months of reaching an agreement on restoration of Kazakhstan's economic interests.

¶5. (U) According to Energy Minister Sauat Mynbayev, only contacts concerning a "limited list of strategic objects" could be subject to termination. The amendments authorize the GOK to define the strategically important areas of subsoil use (fields). Mynbayev stated "this list will be short... The authorized body will not be able to consider all oil projects related to national security. At the same time it is obvious that some big fields should be regulated as strategic objects." According to the executive summary, the amended law will retroactively apply to all contracts relating to either exploration or production. [It would be better in this paragraph to use fewer direct quotes so as to more clearly and succinctly explain what he wanted to convey]

Investors Are Concerned

¶6. (SBU) During the early October KIOGE (Kazakhstan Oil & Gas Exhibition) conference numerous business representatives privately expressed serious concerns about the consequences of the Subsoil draft law's likely enactment. On October 1, Kazakhstan's Foreign Investors' Council Association (FICA), Kazakhstan Petroleum Association (KPA), International Tax & Investment Center (ITIC), American Chamber of Commerce (AmCham) and European Business Association (EUROBAK) sent a joint letter to President Nazarbayev requesting that he veto the draft law. The letter referred, inter alia, to Article 26.3 of Kazakhstan's Constitution, which states, "no one can be deprived of his property unless there is a court

ASTANA 00002931 002.2 OF 002

decision". The letter also expressed serious concerns that the new law would increase the political risks of investing in Kazakhstan and worsen the country's investment climate.

This, Too, Shall Pass?

¶7. (SBU) Uncharacteristically, President Nazarbayev has been slow to sign the draft law since it was approved by Parliament on September 27. Kazakhstan's Constitution gives the president a month to sign a proposed law or send it back to Parliament (suggesting changes or essentially vetoing it). Generally very few draft laws come close to testing this deadline. (Note: some precedents appear to suggest that only workdays are counted. End Note.) President Nazarbayev's slow reaction has led some to speculate that he may still be weighing the relative strengths and weaknesses of the law.

¶8. (SBU) The possible enactment of the Subsoil draft law is but one challenge currently facing energy investors in Kazakhstan. Talks continue between the GOK and the Agip consortium on resolving a conflict over the development of the Kashagan field, with the GOK likely to receive compensation for delays in commercial production (see septel for additional details). Separately, TengizChevrOil (TCO) has been levied with an environmental fine of over \$300 million for illegal sulfur storage, a decision that TCO has appealed.

Comment

¶9. (SBU) Comment: The proposed amendment is one of the latest - and most significant - salvos in the GOK's apparent tightening of its policy toward foreign investors, particularly in the extractive sector. The timing of these amendments was likely not a coincidence, but rather a means of pressuring the Kashagan consortium's foreign shareholders. As Kazakhstan's foreign investors are voicing their displeasure in the faint hope that the draft law will meet a presidential veto, President Nazarbayev

appears to be keeping his options open. One option, which Nazarbayev has exercised with controversial legislation in the past, may be to forward the legislation to the Constitutional Council for review, where it can linger and die. However, the government continues to maintain its support for the amendment; Prime Minister has stated to the Ambassador that he "hopes" Nazarbayev will sign it. End comment.

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